EUROPEAN FINTECH REGULATION – AN OVERVIEW

The use of technology to deliver, enhance or “disrupt” financial services is transforming the sector. Whether you are an institution upgrading the existing financial services that you offer, a new entrant launching a groundbreaking product, or a regulator or an industry body considering whether the current regime is fit for purpose, this overview, produced in cooperation with Kromann Reumert and Arthur Cox, will help you navigate the complex regulatory framework for fintech products across the EU.

Fintech has the potential to increase efficiency and reduce costs, to improve access to, and delivery of, financial services, to enhance the customer experience and to create markets in new and innovative financial services products. It also poses risks, including money laundering, cyber-security, consumer protection and data privacy. However, despite these risks, financial institutions, regulators and challenger companies believe that fintech – and the opportunities it presents – should be embraced.

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Fintech encompasses a wide range of financial services and products that intersect with technology. These include peer-to-peer (or P2P) lending, online payments and foreign exchange services, digital wallets and e-money, automated or robo investment advice, artificial intelligence (AI), big data analytics, blockchain and crypto-currencies and many more. While these products and services are all different, they all make use of new or developing technology to: provide traditional financial services in a more cost-effective, accessible and consumer-friendly way; or facilitate the expansion of new or innovative financial products and services.

The growth of fintech and the expansion of non-financial companies into the heavily regulated financial sector has resulted in a growing need for regulators, the fintech community and the financial services industry to engage fully with developments in this sphere. The vast majority of financial services legislation and regulatory standards predate the rapid advances in technology and consumer demand for innovation. While governments are keen to be seen to be encouraging innovation in a number of jurisdictions, the law has been slower to catch up. Regulators across Europe, including the FCA in the UK, the AMF and ACPR in France, the BaFin in Germany, the CSSF in Luxembourg, the AFM and DNB in the Netherlands, the European Commission and Parliament, the European Central Bank and the European Securities and Markets Authority (ESMA) have, however, publicly announced their support and have launched new regulatory initiatives to encourage innovation in financial services. The latest of these which is likely to have a significant impact is a consultation launched by the European Commission in March 2017 on technology and its impact on the European financial services sector as part of its consumer financial services action plan. Responses are due in June 2017 and will help the European Commission develop its policy approach, for example helping to determine whether further harmonisation is appropriate.

In this overview, we outline the current regulatory framework governing financial services, financial crime and consumer protection applicable to blockchain securities services, robo advice, international FX payments and peer-to-peer lending at an EU level and...
at a local level across Denmark, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Poland, Spain and the UK. We also look at regulatory innovation initiatives in those jurisdictions.

**Blockchain-enabled post-trade securities services**

The use of blockchain technology for post-trade securities services is still in its infancy, with market participants currently focusing on proof of concepts and pilot schemes. However, given the potential benefits on offer (shorter settlement cycles, fewer intermediaries, reduced costs, improved transparency and more efficient reporting) it is only a matter of time before the market is transformed. Blockchain technology is not specifically regulated at an EU level; however, the existing extensive EU legislative regime applicable to post-trade activities is relevant when considering its use for these purposes.

It is clear that a number of potential roadblocks exist to a purist implementation of a blockchain network (one which removes the need for any central infrastructure) and that a number of other requirements will need to be considered carefully and integrated by companies. Some of the more obvious challenges are those where legislation mandates the involvement of entities such as central counterparty clearing house parties (CCPs – where a mandatory clearing requirement applies) or central securities depositories (CSDs – for settlement of securities transactions) which must be legal persons, a condition which a blockchain network is unlikely to meet. In the short to medium term it will be essential to work out how CCPs or CSDs can work efficiently alongside, or as participants in, a blockchain network. Other legislative requirements and practical considerations, such as the incorporation of a reporting or supervisory framework into the blockchain network, will also need to be considered, but in many cases the features of blockchain and, potentially, automation through smart contracts may facilitate gains in efficiency compared to more manual processes.

Beyond the EU framework, no member state considered in this overview has enacted regulations specifically dealing with, or issued direct guidance on the

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**KEY CONCEPTS**

**Blockchain**

A blockchain is a data storage structure which is maintained and replicated across a decentralised network of “nodes” to prevent any individual node from tampering with the information recorded in the ledger by rewriting transaction history. This technology was first applied in the design of Bitcoin and has the potential to revolutionise how transactions are conducted and assets transferred.

**Peer-to-peer (P2P)/marketplace lending**

Rather than a central institution making loans, these are made by “peers” (typically retail or institutional investors) on a multilateral basis (eg one lender may make many loans and one borrower may have many lenders).

**Robo advice**

Individual investment advice is provided by a computer, based on information provided by the client.

**Smart contracts**

While there is no settled market definition, this can refer to agreements where the terms have been translated into code which is able to “self-execute”, ie is able to provide produce outputs autonomously, without the direct intervention of any party.

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use of, blockchain technology for these purposes – it is simply too soon to do so. However, this is likely to change. For example, in Germany the Deutsche Bundesbank is working alongside Deutsche Börse on the development of a preliminary prototype for blockchain-based securities settlement with a view to better understanding the technology and its benefits and limitations. In the meantime the approach that member states have taken in response to the use of blockchain technology for virtual currencies such as Bitcoin, ie focusing on financial crime and identifying other potential regulatory gaps, is likely to be indicative of that taken for broader use of blockchain technology.

The possibility that participants within a blockchain network may be located within different jurisdictions gives rise to a number of interesting legal questions. For example, what should the governing law of the ownership and transfer of relevant assets be and how would potential conflict of laws issues be resolved? Similarly, it will be crucial for those implementing any blockchain network to consider what an appropriate dispute resolution mechanic would be.

Robo advice
EU legislation in relation to robo advice differs depending on the product and distribution model, but the principal financial services legislation relevant for advice on securities products is the Markets in Financial Instruments Directive (MiFID) and for insurance-based products is the Insurance Distribution Directive (IDD). Although these regulatory frameworks for investment services in relation to securities and insurance products generally apply, there are still some gaps or inconsistencies when investment advice is provided on an automated basis.

Broadly, robo advisory services for securities products will require a licence in a member state pursuant to the local implementation of MiFID if they constitute the provision of “personal recommendations in relation to transactions in financial instruments” or meet conditions for certain ancillary services. Robo advisory services relating to insurance would be subject to registration requirements, information requirements and conduct of business obligations under the IDD if they constitute “insurance distribution” but there is no authorisation requirement unless the distributor is an insurance company to which Solvency II applies.

Other legislation may be relevant in relation to specific products or clients, eg the Undertakings for Collective Investment in Transferable Securities (UCITS) IV Directive for funds or the Regulation for Packaged Retail and Insurance-based Investment Products (PRIIP) from 1 January 2018, and consumer protection measures where services are provided to individuals. The position in relation to robo advice in individual member states ranges from those where the general EU framework would be applied, a number where some additional guidance has been issued by local regulators, to the position in the Netherlands, where specific new legislation has been drafted (although not yet enacted) in relation to robo advice.

Outside the strict legislative framework, there are a number of practical considerations that providers of robo advisory services will need to consider. For example, how will more technology-reliant models of robo advice satisfy the need to ensure suitability and appropriateness of the investment products being advised in accordance with the requirements under MiFID, and how should liability be attributed where the service relies on third-party algorithms or technology which falls short of the required standard?

International FX payments
Payments is one of the fastest-moving sectors in terms of innovation and adoption of new technology and the FX market has been transformed by the ability to exchange and transfer currency in (near) real-time, reducing both the currency risk faced by providers and the costs passed on to consumers. The EU framework governing payments is reasonably mature and international FX payment services are the most harmonised product considered in this overview.

The Payment Services Directive (PSD) is the principal piece of legislation governing
payment services in the EU and regulates a number of payment services including the execution of payment transactions, issuing and/or acquiring payment instruments and money remittance, which international payment transfer services are likely to fall under. According to the PSD, providers of these services must be authorised as a credit institution, e-money institution or a payment institution under the Capital Requirements Regulation and Capital Requirements Directive IV (CRD4), Second Electronic Money Directive (2EMD) or PSD, respectively. However, the benefit of obtaining such an authorisation is that the service provider is permitted to provide those services on a pan-EU basis. For most international FX services, the FX element would be provided as an ancillary service to a payment transaction pursuant to the PSD and therefore could be provided under the same licence on a harmonised basis across the EU.

However, there may be some variation in the local analysis for an international FX payment service where some or all of the FX element is not provided as an ancillary service, i.e., a standalone FX spot transaction is entered into. There is divergence in local member state rules and licence requirements for standalone FX spot services as well as around the interpretation of what constitutes “spot” or “forward” transactions. In Ireland, and the UK, no additional licence is required to provide FX services whereas in Denmark, France, Germany, Italy, Luxembourg, the Netherlands, Poland and Spain additional licensing and governance requirements may apply where certain FX services are provided. This divergence in approach is an issue which has persisted in the EU for some time and revisions to relevant legislation have not, to date, addressed the inconsistency.

Peer-to-peer lending

Peer to peer (P2P) or marketplace lending has experienced rapid growth in recent years and is one of the more mature fintech sub-sectors. However, like consumer lending more generally, P2P lending is largely unharmonised at an EU level and so, broadly, the regulatory framework varies within the EU according to local member state rules.

The Consumer Credit Directive (CCD) is one piece of EU legislation that provides limited harmonisation in this area, setting out some basic transparency and consumer protection rules, including the right to withdraw from a credit agreement within 14 days and a right to repay the credit early at any time. While P2P platforms vary considerably in structure, where a P2P platform makes or receives transfers of money, it is likely to be subject to the EU authorisation requirement and transparency, operational and conduct rules applicable to payment institutions. Depending on the structure, a banking licence might also be required in some jurisdictions.

Where loans granted via lending platforms are initiated by banks, the local regime in some jurisdictions may treat such use of the platforms as an outsourcing arrangement and relevant outsourcing rules would be engaged, which may restrict delegation of decisions regarding what loans are to be made, for example.

As there is no broad EU framework that covers P2P lending, the regulatory framework for this product is the most divergent on a local level in this overview. The approach that member states have taken varies from having no specific regulatory regime and therefore reliance on the piecemeal EU regime as is the case in Ireland, Luxembourg and Poland, through to having a specific, local P2P lending regulatory regime as seen in France, the Netherlands, Spain and the UK. In Denmark, Germany and Italy, despite having no separate regime, there has been some regulator engagement and guidance on how the existing regulatory framework applies.

The approach taken by EU member states in part varies based on the maturity of the P2P lending industry in each jurisdiction. We anticipate that as the P2P lending industry continues to grow and becomes more commonplace across Europe, we will see more proactive regulation on a local level, in part driven by platform operators themselves but also other participants in the arrangements. Ultimately, a harmonised regime at an EU level would be beneficial both to platforms and participants and there are indications that the European Commission has an interest in the developing market.
FOCUS ON REGULATORY INNOVATION INITIATIVES

Denmark
The Danish FSA has put together a fintech task force aimed at ensuring that fintech initiatives receive appropriate guidance as to the type of licence, if any, necessary to carry out their contemplated business. The Danish FSA is also considering the potential introduction of a regulatory sandbox inspired by the UK and Singapore models.

France
The AMF and ACPR have created a taskforce with a view to offering a single point of entry for fintech start ups to facilitate a simplified licensing process with the French authorities. In this context, the ACPR has created the “ACPR-FinTech Innovation Pole”, a team dedicated to fintech that welcomes innovative project initiators. It intends to ease the filing and approval process for fintechs. The AMF and ACPR have also created an advisory body called the “Forum FinTech” with the aim to provide support to the fintech industry and, in particular, offer them guidance on the most appropriate regime for each entity.

Following the result of the UK’s EU referendum, a “2WeekTicket” licensing procedure has been introduced by the AMF for fintech companies currently supervised by the FCA. This new programme called “AGILITY”, is based on a pre-authorisation regime which, according to AMF’s press release, should not take more than two weeks from the date of submission of the form to the FCA. Once the pre-authorisation has been obtained, subject to meeting certain formalities, the AMF commits to deliver a full authorisation within two months.

Similarly, the ACPR published a press release in September 2016 stating that the authorisation process would be enhanced and simplified for, among others, English credit institutions, payment institutions and insurance companies. Separately, the Banque de France has launched a feasibility study for the implementation of a blockchain architecture.

In December 2016 the Banque de France announced that it has launched a blockchain initiative and experiment with a group of banks and institutions, including the Caisse des dépôts et consignations and the start-up Labo Blockchain. This initiative creates an opportunity for the market to discuss the potential of blockchain technology.

Germany
BaFin provides some general regulatory guidance for fintech companies and has created an internal task force. Individuals may contact BaFin via its website about general regulatory issues as well as a specific business model. BaFin also provides FAQs on its website regarding the regulatory requirements for several common fintech business models. In addition, BaFin organises seminars on fintech and has expressed several times that it takes an “open-mind” approach.

Nevertheless, BaFin has not started any initiatives to ease regulatory requirements for fintech companies, and has made it clear that fintech companies are expected to meet applicable legal requirements. Consequently, if a certain business activity requires a banking or financial service licence, the same requirements would apply for a new market entrant as for any other financial market participants.

Ireland
The Central Bank of Ireland has not introduced any “light” regulatory initiatives for fintech companies, and has made it clear that fintech companies are expected to meet all applicable legal requirements. Consequently, if a certain business activity requires a regulatory licence, the same requirements would apply for a new market entrant as for any
other market participants. Ireland does, however, have a very strong tech industry, with many global tech companies having their EU headquarters in Ireland. Fintech is an important component of the Irish government’s strategy for Ireland’s international financial services sector for 2015 – 2020.

**Italy**
The Italian Government has adopted specific legislation to promote innovative entrepreneurship, applying generally to so-called “innovative” start-up companies and including incentive measures to support these companies. Although no definition is provided of the term “innovative”, fintech companies with an exclusive or prevalent goal of developing, producing or selling innovative products and services with high technological value would typically meet these requirements.

While the legislation does not impact licensing requirements, it does provide for a number of incentives and derogations from the standard company law framework, including simplified procedures for incorporation and enhanced access to Italy’s State Guarantee Fund for SMEs (Fondo centrale di garanzia per le piccolo e medie imprese).

Separately, the Bank of Italy and Consob (Commissione Nazionale per le Società e la Borsa) have also held round-tables and seminars with a number of Italian institutions to discuss fintech, with themes including market trends and practices, future opportunities and related risks.

**Luxembourg**
The Luxembourg CSSF has established a dedicated division for financial innovation and technology. The CSSF was the first European supervisory authority to take a clear stand in favour of virtual currencies and their regulation; a position subsequently confirmed by the Court of Justice of the European Union. In addition, in order to foster innovation, several initiatives have been implemented at a national level by the CSSF and the Luxembourg legislator over the last year, such as: adopting legislation to permit simplified customer due diligence for low-value online payment transactions; and taking an open approach regarding IT outsourcing by Luxembourg institutions.

The CSSF is an open regulator, particularly when it comes to fintech companies seeking to establish themselves in Luxembourg; the CSSF has received and dealt with a great number of requests for clarification on the perimeter and application of existing regulations. The CSSF stresses that it takes a technologically neutral approach when assessing new projects and in relation to fintech companies in general.

**The Netherlands**
The AFM and the DNB have set up an “InnovationHub” to support companies that seek to market innovative financial services or products but are uncertain about the rules to encourage innovation in the financial sector. The InnovationHub offers new businesses and incumbent firms the opportunity to submit questions about regulations directly to a supervisory authority, irrespective of whether they are currently subject to supervision.

From 1 January 2017, fintech companies are also able to apply to the AFM and DNB to request the application of a regulatory sandbox. The regulatory sandbox is available to all companies looking to offer an innovative financial product, service or business model; however, the relevant supervisor will determine how and under what conditions the sandbox would be implemented for each applicant. More conventional methods which also apply to encourage innovation in the financial services industry comprise “partial authorisations” (where certain licensing requirements are relaxed and
activities of the licence holder may be limited), "authorisations with requirements and restrictions" (where the licence is tailored to allow for bespoke arrangements) and an "opt-in banking licence" (where the licence is limited to the activity of: (i) receiving deposits or other repayable funds from parties other than the public and granting credit for its own account; or (ii) receiving deposits or other repayable funds from the public or other parties without undertaking lending activities).

Poland
The Ministry of Development, Ministry of Digital Affairs, Ministry of Finance and Ministry of Health are developing a programme “From a paper to a digital Poland” (“Od papierowej do cyfrowej Polski”) to set the agenda for development of an e-state and digitisation of the economy. There are 13 streams operating within the programme, including the Blockchain and Cryptocurrency Stream, which is to focus on the implementation of distributed ledgers and promoting their application in business.

In addition, a working group composed of, among others, representatives of the Ministry of Finance, Ministry of Development and the PFSA is to perform a review of existing law and supervisory regulations in order to identify any possible regulatory barriers to the development of innovative technological offerings in the field of financial services.

Spain
In December 2016 the CNMV launched a new fintech and innovation portal on its website for the purpose of: assisting sponsors and financial companies on issues related to securities markets regulations; and creating an informal forum for exchanging information on fintech initiatives.

The UK
In October 2014 the FCA launched Project Innovate, which aims to provide direct support to innovative firms through an Innovation Hub and also targets policy and process improvement activities. These include the execution of international cooperation agreements for development of the fintech industry with the Australian Securities and Investments Commission, the Monetary Authority of Singapore and the Korean Financial Services Commission. In May 2016 the FCA was the first regulator to launch a regulatory sandbox initiative, allowing businesses to test out new, innovative financial services without incurring all the normal regulatory consequences of engaging in those activities.

The FCA has also published feedback following a call for input on RegTech and guidance on firms outsourcing to the ‘cloud’ and other third-party IT services in 2016. The UK government has also shown interest in technology and innovation, for example commissioning a report in January 2016 by its Chief Scientist, Sir Mark Walport, exploring how distributed technology could transform the delivery of public services and boost productivity. The Bank of England launched a fintech accelerator in June 2016 to help it harness fintech innovations for central banking by working with small cohorts of successful applicants on short proof of concepts in priority areas, such as cyber resilience, desensitisation of personal data and the capability of distributed ledger technology.

Fintech has also received backing from the UK government, including HM Treasury’s appointment of a fintech envoy and fintech roundtables being organised with relevant ministers and a number of fintech firms.

In April 2017, HM Treasury published a regulatory innovation plan for financial services following a 2016 consultation. The plan covers the work of the FCA, the Prudential Regulation Authority, the Payment Systems Regulator and the Bank of England and outlines how the approach of each of these to regulation will support and promote innovation and breaking down barriers to entry.

Clifford Chance has produced a more in-depth report on the regulation of fintech products in Europe. For further information or to request a copy please contact fintech@cliffordchance.com
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